

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT
ACT
R.S.C. 1985 c.C - 36, as amended**

- and -

**IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF
KOREX DON VALLEY ULC**

APPLICANT

SUPPLEMENTARY FIRST REPORT OF IRA SMITH TRUSTEE & RECEIVER INC.

**IN ITS CAPACITY AS PROPOSED COURT-APPOINTED MONITOR OF
KOREX DON VALLEY ULC**

DATED JANUARY 22, 2009

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SUPPLEMENTARY FIRST REPORT OF IRA SMITH TRUSTEE & RECEIVER INC.

**IN ITS CAPACITY AS PROPOSED COURT-APPOINTED MONITOR OF
KOREX DON VALLEY ULC**

DATED JANUARY 22, 2009

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DATED JANUARY 22, 2009

1.0 INTRODUCTION

This Supplementary First Report (the "**Supplementary First Report**") is filed by Ira Smith Trustee & Receiver Inc. ("**ISI**") in its capacity as proposed court-appointed monitor (the "**Monitor**") of all of the assets, undertakings and properties of Korex Don Valley ULC ("**Korex**"). This is supplementary to the First Report of the Monitor dated January 9, 2009 (the "**First Report**").

On January 2, 2009, by Endorsement of the Honourable Mr. Justice Campbell, the Monitor was directed to perform certain work as part of an adjournment on a consent basis of the within

application. A copy of the Endorsement and Consent was included as Exhibit "A" in the First Report.

On January 12, 2009, the parties attended before the Honourable Madam Justice Pepall to seek an adjournment of the hearing of Korex's motion. By endorsement of Justice Pepall, the First Report was not filed with this Honourable Court at that time. Attached as **Exhibit "A"** is a copy of that endorsement.

Purpose of this Report

On January 19, 2009, by Endorsement of the Honourable Mr. Justice Morawetz, the Monitor was directed to file a Report for the next attendance (January 23, 2009) providing an up to date summary of key events (the "**January 19 Endorsement**").

Attached as **Exhibit "B"** is a copy of January 19 Endorsement.

As indicated in Korex's Motion Record, the sole secured creditor is Comerica Bank ("**Comerica**"). The Monitor has been communicating on a regular basis with representatives of Comerica. Both Comerica and Korex, and their respective legal counsel, have received a copy of this Supplementary First Report.

2.0 Disclaimer

The Monitor has relied upon the financial records and financial statements of Korex, as well as other information supplied by Messrs. S. Pensler (President) and Mr. J. Bojkovski (Chief Financial Officer). Our procedures did not constitute an audit or review engagement.

Our procedures and enquiries did not include verification work or constitute an audit in accordance with generally accepted auditing standards. In the event any of the information we relied upon was inaccurate or incomplete, the results of our analysis could be materially affected. As well, we have assumed that Korex will continue as a going-concern, and that current business conditions will remain status quo, including but not limited to, commodity and other input prices. As well, the Monitor did not review internal plans and support budgets such as sales, manufacturing and marketing plans or budgets. The Monitor's analysis is subject to the reasonableness of all of the assumptions used in such plans and budgets, and the future business conditions Korex will encounter.

Therefore, the Monitor is unable to and does not express an opinion on any financial statements, or elements of accounts referred to in this First Report, or any of the attached Appendices or Exhibits forming part of this Supplementary First Report. We reserve the right to review all calculations included or referred to in this Supplementary First Report and, if we consider it necessary, to revise our calculations or conclusions in light of new information as such information becomes available.

3.0 FINANCIAL UPDATE

The Monitor requested updated financial information for the purpose of this Supplementary First Report. Korex was able to provide certain updated information, which is commented on below. The Monitor cannot make any comment on categories where no additional information was provided.

Cash

In the First Report, the Monitor reported on the bank accounts which Korex established outside of Comerica's control maintained at The Toronto-Dominion Bank (the "Bank"). The Monitor further reported that the Monitor believed that, as at November 30, 2008, the proper reconciled CDN dollar equivalent balance in accounts not controlled by Comerica was \$1,050,925. The Monitor advises that based on its review, it believes the balance as at January 22, 2009 is \$1,267,457.

Below is an update to the summary previously provided by the Monitor in the First Report on such cash balance maintained at the Bank.

	\$ BALANCE		
	<u>31-Dec-08</u>	<u>6-Jan-09</u>	<u>22-Jan-09</u>
CDN CHEQUING ACCOUNT ENDING IN 229	482,291	451,786	499,076
CDN INVESTMENT ACCOUNT ENDING IN 237	303,240	303,240	387,184
	<u>785,531</u>	<u>755,026</u>	<u>886,260</u>
US CHEQUING ACCOUNT ENDING IN 052	<u>650,599</u>	<u>596,693</u>	<u>308,113</u>
CDN TOTAL (US\$=CDN\$1.2372)	<u>1,590,452</u>	<u>1,493,255</u>	<u>1,267,457</u>

Therefore, there has not been any diminution in the funds on hand in these accounts.

Accounts receivable

The Monitor reported on the trade accounts receivable in the First Report. The Monitor advises that based on the trade accounts receivable listing reviewed as at January 20, 2009, the combined

converted balance of US and CDN accounts receivable as at that date is CDN\$5,842,683 (CDN\$5,899,468 as at November 30, 2008 as described in the First Report and CDN\$5,753,144 as at December 31, 2008).

The Monitor notes that although the change in total trade accounts receivable is not significant, there is an increase in the 91+ days old category in the amount of \$107,234.

Sales

Korex reported that sales for the month of December 2008 were in the amount of \$1,827,037, which is accordance with its earlier forecast. Korex has advised the Monitor that sales for the period January 1 to 20, 2009, inclusive, were \$1,676,724, as compared to a forecast of \$1,494,000. The Monitor has not been provided with any additional information regarding sales product mix or profitability of products sold.

4.0 CASH FLOW

The Monitor's review, as indicated above, indicates that Korex's cash balance has decreased by the amount of CDN\$322,995 between December 31, 2008 and January 22, 2009 (CDN\$1,590,452 minus CDN\$1,267,457). Korex's cash flow forecast previously provided to the Monitor and Comerica Bank indicated that during this period, cash would decrease by the amount of CDN\$389,000.

The major use of cash was the wire transfer of US\$390,000 to two major suppliers for the supply of sulphination and other raw materials. Korex advises that it is required by these suppliers to pay when the products are ordered, given Korex's current financial position. Korex advises that

these products are essential to Korex's business, and that the lead time between the order and payment for the purchases, and the delivery of such raw materials is several weeks.

5.0 OTHER MATTERS

Comerica

Korex advises that as Comerica has frozen Korex's borrowings, and as Korex has not paid any amounts to Comerica, the amount of Korex indebtedness to Comerica has not changed, except for accrued interest and costs. The Monitor requested an updated borrowing base calculation, but Korex advised that it had not prepared one. Accordingly, the Monitor cannot express any view on the borrowing base calculation at this time. Subject to the qualifications contained in this Supplementary First Report, the Monitor is of the view that since the date of the First Report, the position of Comerica has not been prejudiced.

Requests by Monitor

On January 19, 2009, the Monitor sent an email (the "**January 19 email**") to representatives of both Korex and Comerica, and their respective legal counsel, advising of the January 19 Endorsement and that the Monitor's representative would be contacting the Korex representative to obtain updated financial information. The Monitor also requested of both Korex and Comerica that, in order for the Monitor to be able to discharge its duties pursuant to the January 19 Endorsement, both Korex and Comerica should keep the Monitor apprised of any events of significance that may transpire.

Attached as **Exhibit "C"** is a copy of the January 19 email.

6.0 MATERIAL ADVERSE CHANGE

Subsequent to issuing the renewed request for information on January 22, 2009, the Monitor was copied on an email sent by Mr. B. Darlington of Davis LLP, legal counsel to Korex to legal counsel for Comerica. Attached as **Exhibit "D"** is a copy of that email.

That email makes reference to discussions that had been ongoing between counsel concerning an attempt for Korex and Comerica to enter into a forbearance agreement. However, more importantly, the email advises of a material adverse change in that "Our client has advised us that one of its most significant customers appears to be withdrawing its support and reducing its orders from Korex...". Mr. Darlington further states on behalf of Korex that:

"It is our view that an orderly winding down of the Korex Business under CCAA protection and the supervision of the Monitor over the next 30 to 60 days will be in the best interest of all stakeholders. In addition to providing an opportunity to maximize recoveries for Comerica, the process will permit Korex to continue to explore its options for downsizing and restructuring its business."

The Monitor sent an email to Comerica representatives advising that the Monitor was completing the Supplementary First Report and that Mr. Darlington's email was: (i) obviously a new and significant matter that the Monitor must report on; and (ii) advising that prior to finalizing the Supplementary First Report, requesting that if Comerica had any information it wished to provide to the Monitor for inclusion in such Report, it should do so. Attached as **Exhibit "E"** is a copy of that email.

At the time of writing this Supplementary First Report that Monitor has had no reply to that email, but the Monitor is advised that Mr. Darlington and Comerica's legal counsel have had subsequent conversations regarding this material adverse change.

Messrs. I. Smith and S. Sugar of the Monitor held a conference call with Messrs. Pensler and Bojkovski, Mr. B. Darlington and Ms. T. Buchanan of Davis LLP and Mr. S. Mitra of Aird & Berlis LLP, counsel to the Monitor, in order for the Monitor to further explore this material adverse change with Korex. The Monitor was advised that the major customer is Phoenix Brands LLC (commented on in the First Report).

Messrs. Pensler and Bojkovski further advised that the anticipated reduction in purchases by this significant customer will produce long term irreparable harm to Korex's business such that continuing to attempt to restructure as originally contemplated in Korex's original application was no longer an option, and that an orderly liquidation of the assets subject to Comerica's security, in order to retire the Comerica indebtedness, while restructuring Korex's financial affairs and business, was the only viable option.

The Monitor asked if Korex had revised its cash flow to show how operations would continue between now and when it was anticipated that the motion for Korex's request for protection pursuant to the *Companies' Creditors Arrangement Act* R.S.C. 1985 c.C - 36, as amended ("CCAA") would be heard, so that the Monitor could review it and provide its comments in this Supplementary First Report, and to provide comfort to Comerica in the intervening period. Korex advised that as this material adverse change was very recent, it had not yet had the opportunity to revise its cash flow projections and budget, but it undertook to do so as soon as possible.

The Monitor advised Korex that it would be preferable for the Monitor to be able to obtain and review such revised cash flow projection as soon as practical, and to be able to report to both Korex and Comerica on it. Further, the Monitor advised Korex that given this material adverse

change, and Korex's view that a self-liquidation was in the best interests of all stakeholders, a revised cash flow projection would also have to be submitted to this Honourable Court as part of the hearing of Korex's application for CCAA protection.

7.0 MONITOR'S INITIAL ASSESSMENT OF KOREX REACTION

The Monitor has considered Korex's position that its restructuring under CCAA, should such protection be granted by this Honourable Court, must now take the form of a debtor in possession self-liquidation of assets in order to retire the Comerica indebtedness, while attempting to restructure its business and affairs for the benefit of its other stakeholders. The Monitor believes that Korex liquidating its inventory and accounts receivable, while continuing to produce product on a more limited basis, in order to support its customer base for as long as necessary for those customers who will not be continuing as Korex customers, and to support those customers that Korex wishes to attempt to continue with as part of its restructuring, will produce the highest realizable value on the inventory and accounts receivable, as opposed to a recovery under either a non-operating receivership or bankruptcy proceeding.

The Monitor also notes that in the Affidavit of Mr. Bojkovski, previously filed in Korex's motion record, Mr. Bojkovski provides information concerning the unionized Korex employees on strike and the circumstances under which Korex has been attempting to operate in that unionized employee environment. The Monitor also understands that Korex's Toronto manufacturing facility provides challenges from an environmental perspective.

The Monitor believes that by pursuing a debtor in possession self-liquidation plan, Korex is also aiding Comerica Bank. The Monitor believes that without a secured creditor providing either a receiver or trustee in bankruptcy a significant indemnity, it may not be possible to find a firm

willing to take on a mandate to act as either receiver or trustee in bankruptcy for the purpose of liquidating the assets of Korex. The Monitor does not believe that any secured creditor would be willing to give an indemnity to allow such receiver or trustee to operate the business.

The Monitor further believes that the combination of the unionized environment, environmental challenges and a reduced realization if Korex ceases to operate, will assure no recovery for the unsecured creditors. This conclusion is tentative and subject to change.

Therefore, the Monitor supports Korex's view that it should seek CCAA protection in order to self-liquidate the assets subject to Comerica's security for the benefit of Comerica, under the supervision of this Honourable Court, while attempting to restructure its financial affairs and business for the benefit of its other stakeholders. This support is subject to Comerica's right to information on whatever basis it requires during the initial stay period, and any extensions to be granted by this Honourable Court, and Korex's cash flow projections supporting such endeavour.

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All of which is respectfully submitted at Toronto, Ontario this 22nd day of January, 2009.

IRA SMITH TRUSTEE & RECEIVER INC.

solely in its capacity as the Proposed Court-Appointed Monitor
of Korex Don Valley ULC and not in its personal Capacity

Per: _____

President

2 Jan 2009

Court File No. 08-CL-7925

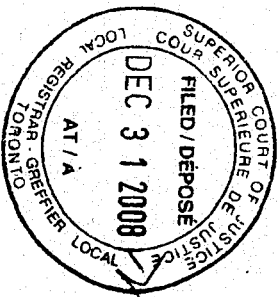
IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, S.C. 1985 c.c. - 36, as amended
IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF KOREX DON VALLEY ULC

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT TORONTO

LATE FILING

APPLICATION RECORD OF THE APPLICANT
(Returnable January 2, 2009)



DAVIS LLP
Barristers & Solicitors
1 First Canadian Place, Suite 5600
100 King Street West
Toronto, ON M5X 1E2

Susan E. Friedman (LSUC #24991U)
Tel: 416.365.3503
Fax: 416.777.7415
Email: sfriedman@davis.ca

Lawyers for the Applicant

Jan 2/09
Dear Counsel - adjournment requested
re Jan 2/09 per Mr. Don Kerner
and set out in (attached) notes
by letters of introduction to you.

RAC Company

Jan 12/09

1. Counsel for Mr Smith has advised that the work described in para 5 of the court order of Campbell's has been done. A report will be filed for the purpose of the next court hearing.
2. On consent, the adjournment is adjourned to Jan 19/09 for a hearing on the above terms as set forth in Campbell's order with the exception of para 5 + 1. Consents required from the file materials in response.

SR Beall, J

Ira Smith

From: Ian Aversa [iaversa@airdberlis.com]
Sent: January 19, 2009 1:00 PM
To: Ira Smith
Cc: Sanj Mitra; Richard Epstein
Subject: Korex Don Valley ULC
Attachments: Endorsement of Justice Morawetz made on Jan. 19_09.PDF; Endorsement of Justice Morawetz made on Jan 19_09.DOC

Gentlemen,

Please find attached Justice Morawetz's Endorsement dated January 19, 2009 in respect of the above noted matter. For your convenience, I've also prepared and attached a transcription of the Endorsement.

Regards,

Ian

Ian E. Aversa | Associate
Aird & Berlis LLP | Barristers and Solicitors
Brookfield Place | 1800 - 181 Bay Street
Toronto, ON | M5J 2T9 | Canada
Bus: 416.865.3082 | Fax: 416.863.1515
Cell: 416.509.3822 | Res: 416.363.0806
Email: iaversa@airdberlis.com

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<<Endorsement of Justice Morawetz made on Jan. 19_09.PDF>> <<Endorsement of Justice Morawetz made on Jan 19_09.DOC>>

January 19/09

The parties are not in a position to proceed.

Proposed mediation ⁱⁿ ~~by~~ ^{the} parties to ~~be~~ ^{be} held ~~on~~ ^{on} ~~the~~ ^{the} 23/10/09 at 9:30 a.m.
Proposed Monitor to file a Report ~~at~~ ^{at} ~~the~~ ^{the} ~~next~~ ^{next} attendance which provides up to date summary of key assets.

The purpose of the hearing - January 23/10/09 is to either schedule a fixed hearing date if matter is going to proceed or to consider whether the Applicant should be withdrawn.

A. J. [Signature]

**ONTARIO
SUPERIOR COURT OF JUSTICE
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KOREX DON VALLEY ULC**

APPLICANT

ENDORSEMENT OF JUSTICE MORAWETZ

January 19, 2009

The parties are not in a position to proceed. Protracted negotiations ongoing. Parties to re-attend Friday, January 23, 2009 at 9:30 a.m.

Proposed Monitor to file a Report for next attendance which provides up to date summary of key events.

The purpose of the hearing on January 23/09 is to either schedule a fixed hearing date if matter is to proceed or to consider whether the Application should be withdrawn.

Justice Morawetz

Ira Smith

From: Ira Smith
Sent: January 19, 2009 5:14 PM
To: 'John Bojkovski'; ELJones@comerica.com; Sandy Pensler
Cc: Darlington, Bruce; Stanley Sugar; 'Richard Epstein'; Sanj Mitra; 'iaversa@airdberlis.com'
Subject: Korex - Endorsement of Morawetz J 01 19 09
Attachments: Endorsement of Justice Morawetz made on Jan 19_09_3.pdf

Gentlemen:

As you know, this morning in Court, Mr. Justice Morawetz directed the Proposed Monitor file a Report this coming Friday in Court with an update of key events. Attached is a typed version of His Honour's Endorsement.

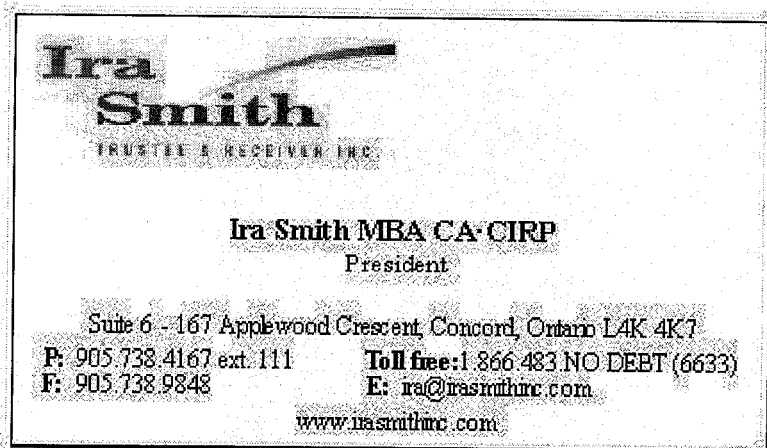
Therefore, Stan Sugar of my office will be contacting John Bojkovski tomorrow morning by telephone, in order to obtain updated financial information for the key areas discussed in our First Report to Court, with appropriate backup. John, my current thinking is that Stan can do this by telephone, email and fax and not need to attend at the Korex premises.

As well, in order for us to be able to discharge our duties, I would ask that both Korex and Comerica representatives keep us apprised, preferably by email, on any events of any significance that may transpire, including, but not limited to, Korex's operations, Comerica's loan position the proposed forbearance agreement or any other matters or things you believe may be appropriate for us to report on.

If you have any questions, please contact us.

IRA SMITH TRUSTEE & RECEIVER INC.
solely in its capacity as Proposed Monitor of
Korex Don Valley ULC and not in its personal capacity

Ira Smith
President



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Ira Smith

From: Darlington, Bruce [bdarlington@davis.ca]
Sent: January 22, 2009 2:44 PM
To: Marentette, Stephen R.; Leslie, John D.; Hewitt, Jeffrey J.
Cc: Friedman, Susan; Buchanan, Teresa; Sanford Pensler; Ira Smith; smitra@airdberlis.com
Subject: FW: Forbearance Agreement, Jan 21, 12:00pm

Stephen, John and Jeffery:

I think our clients have two fundamental issues that they are not going to be able to reach agreement on. Your client is insisting that our client provide security over its equipment. This is security over assets that your client currently does not have an interest in. The second issue, which is related to the first, is that your client's obligation to fund and to standstill is subject to discretionary defaults such as "material further deterioration in the financial condition" or "further deterioration in Bank's collateral position beyond what is contemplated herein" or even more broad if the Bank "for any reason, believes that the prospect of payment or performance is impaired".

My client feels that it is not in the best interests of Korex and the other stakeholders in Korex to add assets to your client's collateral and leave continuing funding and worse, continued forbearance, essentially to your client's discretion.

I think we may have to leave these issues to be determined by the court. We do caution your client that in our client's view a forced liquidation of the assets by a receiver will generate considerably less proceeds for the stakeholders than an orderly winding down of the business under CCAA protection.

Our client has advised us that one of its most significant customers appears to be withdrawing its support and reducing its orders from Korex as a result of the continued and perhaps increased uncertainty about Korex's ability to deliver. This puts Korex's plan to restructure in serious jeopardy. As a result, it is now our client's intention to reduce its staff dramatically. The plan is to announce the reduction of about 50% of its workforce on Monday and implement the reduction on Friday. Therefore starting February 2nd, Korex's primary focus will be on liquidating its existing inventory and collecting the outstanding receivables. The sulfonation production will continue as will the Defi operation but only for the short term for Defi. The expectation is that Korex will cease to produce liquids by the end of March or April. The goal will be to run through as much raw material as possible in co-ordination with notice to the customers to maximize receivable collection by minimizing set off claims.

You should also be aware that discussions are underway with a potential customer that may result in a liquid soap order. If this project is landed there will be need for an employee recall and additional funding to be negotiated likely involving a new lender. However, as the order has not been received, Korex is now focusing on the plan to wind down to sulfonation production only within the first quarter of this year. Korex is developing updated financial projections based on the winding down scenario. These projections should be available within the next 10 days.

It is our view that an orderly winding down of the Korex business under CCAA protection and the supervision of the Monitor over the next 30 to 60 days will be in the best interests of all stakeholders. In addition to providing an opportunity to maximize recoveries for Comerica, the process will permit Korex to continue to explore its options for downsizing and restructuring its business.

Under the circumstances, we would ask that you turn your attention to the proposed Initial Order and are prepared to discuss you comments in that regard at your earliest convenience.

Regards, Bruce

From: Marentette, Stephen R. [mailto:Marentette@MillerCanfield.com]
Sent: Wednesday, January 21, 2009 12:39 PM
To: Darlington, Bruce
Subject: Forbearance Agreement, Jan 21, 12:00pm

Bruce,

Please find attached hereto changes made to the forbearance agreement, not yet approved by the bank. I accepted the changes that we were fine with. You will see that paragraph 26 is new. Paragraph 25 and 38 have changes. The remainder of the redlined changes are primarily a return to the agreement we sent you last week.

I will be in and out of the office until 3pm. Therefore here are my comments:

- a- Regarding page 2 "As a result... the Borrower". This must stay in.
- b- Paragraphs 2-9. These are standard terms in forbearance agreements to protect the bank from future disputes.
- c- para 11: this was previously accepted by your client, not sure why it comes out
- c- 26(b): we think 15% is a compromise.
- d- 27 and 28: Any payment the bank receives should not be a preference given its security position. However, the bank wants this safety net.
- e- Last paragraph: We kept everything here (your addition and the eliminated portion). It was previously sent to Comerica on December 22 in this fashion. We did change "insolvency proceeding" to CCAA.

My client is fine with the salary of \$10,000 per month. We can acknowledge it in a letter or otherwise if you wish.

Please let me know if you are able to discuss this matter after 3pm today and we can finalise it. Please be advised that the bank will not support the CCAA proceeding should a forbearance agreement not be reached. It will seek to appoint a receiver.

Very Truly Yours,

**MILLER
CANFIELD**

Stephen Marentette

Miller, Canfield, Paddock and Stone LLP

Barristers and Solicitors

300-443 Ouellette Avenue

P.O. Box 1390

Windsor, Ontario N9A 6R4

Phone: (519) 561-7433

Fax: (519) 977-1565

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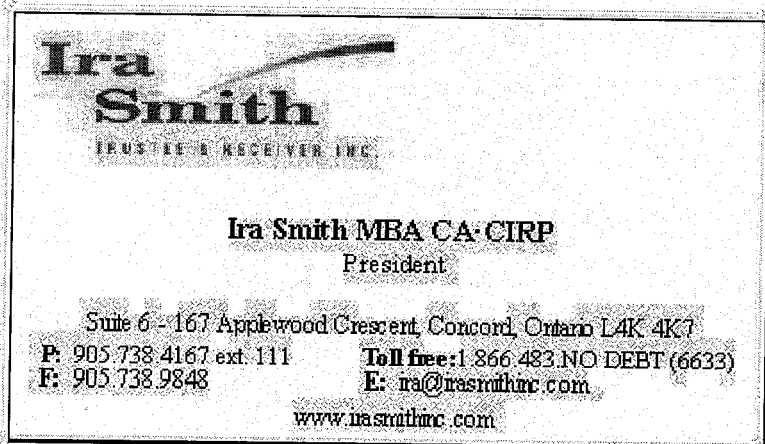
return e-mail, delete this e-mail and do not copy, use or disclose it.
Please advise us if you do not want to receive unencrypted e-mails.

Ira Smith

From: Ira Smith
Sent: January 22, 2009 4:23 PM
To: 'Darlington, Bruce'; Marentette, Stephen R.; Leslie, John D.; Hewitt, Jeffrey J.; 'ELJones@comerica.com'
Cc: Friedman, Susan; Buchanan, Teresa; Sanford Pensler; smitra@airdberlis.com
Subject: RE: Forbearance Agreement, Jan 21, 12:00pm

We are completing our report to Court and the email below is obviously a new and significant matter that we must report on. Prior to finalizing our report today, I would ask if Comerica has any information it wishes to provide us with so that we may include it in our Report to Court.

Thank you.



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From: Darlington, Bruce [mailto:bdarlington@davis.ca]
Sent: January 22, 2009 2:44 PM
To: Marentette, Stephen R.; Leslie, John D.; Hewitt, Jeffrey J.
Cc: Friedman, Susan; Buchanan, Teresa; Sanford Pensler; Ira Smith; smitra@airdberlis.com
Subject: FW: Forbearance Agreement, Jan 21, 12:00pm

Stephen, John and Jeffery:

I think our clients have two fundamental issues that they are not going to be able to reach agreement on. Your client is insisting that our client provide security over its equipment. This is security over assets that your client currently does not have an interest in. The second issue, which is related to the first, is that your client's obligation to fund and to standstill is subject to discretionary defaults such as "material further deterioration in the financial condition" or "further deterioration in Bank's collateral position beyond what is contemplated herein" or even more broad if the Bank "for any reason, believes that the prospect of payment or performance is impaired".

My client feels that it is not in the best interests of Korex and the other stakeholders in Korex to add assets to your client's collateral and leave continuing funding and worse, continued forbearance, essentially to your client's discretion.

I think we may have to leave these issues to be determined by the court. We do caution your client that in our client's view a forced liquidation of the assets by a receiver will generate considerably less proceeds for the stakeholders than an orderly winding down of the business under CCAA protection.

Our client has advised us that one of its most significant customers appears to be withdrawing its support and reducing its orders from Korex as a result of the continued and perhaps increased uncertainty about Korex's ability to deliver. This puts Korex's plan to restructure in serious jeopardy. As a result, it is now our client's intention to reduce its staff dramatically. The plan is to announce the reduction of about 50% of its workforce on Monday and implement the reduction on Friday. Therefore starting February 2nd, Korex's primary focus will be on liquidating its existing inventory and collecting the outstanding receivables. The sulfonation production will continue as will the Defi operation but only for the short term for Defi. The expectation is that Korex will cease to produce liquids by the end of March or April. The goal will be to run through as much raw material as possible in co-ordination with notice to the customers to maximize receivable collection by minimizing set off claims.

You should also be aware that discussions are underway with a potential customer that may result in a liquid soap order. If this project is landed there will be need for an employee recall and additional funding to be negotiated likely involving a new lender. However, as the order has not been received, Korex is now focusing on the plan to wind down to sulfonation production only within the first quarter of this year. Korex is developing updated financial projections based on the winding down scenario. These projections should be available within the next 10 days.

It is our view that an orderly winding down of the Korex business under CCAA protection and the supervision of the Monitor over the next 30 to 60 days will be in the best interests of all stakeholders. In addition to providing an opportunity to maximize recoveries for Comerica, the process will permit Korex to continue to explore its options for downsizing and restructuring its business.

Under the circumstances, we would ask that you turn your attention to the proposed Initial Order and are prepared to discuss your comments in that regard at your earliest convenience.

Regards, Bruce

From: Marentette, Stephen R. [mailto:Marentette@MillerCanfield.com]
Sent: Wednesday, January 21, 2009 12:39 PM
To: Darlington, Bruce
Subject: Forbearance Agreement, Jan 21, 12:00pm

Bruce,

Please find attached hereto changes made to the forbearance agreement, not yet approved by the bank. I accepted the changes that we were fine with. You will see that paragraph 26 is new. Paragraph 25 and 38 have changes. The remainder of the redlined changes are primarily a return to the agreement we sent you last week.

I will be in and out of the office until 3pm. Therefore here are my comments:

- a- Regarding page 2 "As a result... the Borrower". This must stay in.
- b- Paragraphs 2-9. These are standard terms in forbearance agreements to protect the bank from future disputes.
- c- para 11: this was previously accepted by your client, not sure why it comes out
- c- 26(b): we think 15% is a compromise.
- d- 27 and 28: Any payment the bank receives should not be a preference given its security position. However, the bank wants this safety net.

e- Last paragraph: We kept everything here (your addition and the eliminated portion). It was previously sent to Comerica on December 22 in this fashion. We did change "insolvency proceeding" to CCAA.

My client is fine with the salary of \$10,000 per month. We can acknowledge it in a letter or otherwise if you wish.

Please let me know if you are able to discuss this matter after 3pm today and we can finalise it. Please be advised that the bank will not support the CCAA proceeding should a forbearance agreement not be reached. It will seek to appoint a receiver.

Very Truly Yours,

**MILLER
CANFIELD**

Stephen Marentette

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**IN THE MATTER OF THE COMPANIES' CREDITORS
ARRANGEMENT ACT**

R.S.C. 1985 c.C - 36, as amended

- and -

**IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF
KOREX DON VALLEY ULC**

APPLICANT

Court File No. 08-CL-7925

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

**SUPPLEMENTARY FIRST REPORT OF
IRA SMITH TRUSTEE & RECEIVER INC.
IN ITS CAPACITY AS PROPOSED COURT-APPOINTED MONITOR OF
KOREX DON VALLEY ULC
DATED JANUARY 22, 2009**

**IRA SMITH TRUSTEE & RECEIVER INC.
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